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Department of the Treasury
Internal Revenue Service

Instructions for Form 8582

Passive Activity Loss Limitations

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	26 min.
Learning about the law or the form	1 hr., 11 min.
Preparing the form	1 hr., 24 min.
Copying, assembling, and sending the form to IRS	35 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from you. You can write to either IRS or the Office of Management and Budget at the addresses listed in the instructions of the tax return with which this form is filed.

General Instructions

Purpose of Form

Form 8582 is used by noncorporate taxpayers to figure the amount of any passive activity loss for the current tax year and the amount of losses from passive activities allowed on your tax return. You have a passive activity loss for the year if the total losses (including prior year unallowed losses) from all of your passive activities exceed the total income from all of your passive activities.

Passive activity losses cannot be used to offset income from nonpassive activities. However, a special allowance for rental real estate activities with active participation may allow some losses even if the losses exceed passive income. These rules are discussed in more detail on pages 3 and 4.

Passive activity losses that are not allowed in the current year are carried forward until they are allowed either against passive activity income, against the special allowance, if applicable, or when you sell or exchange your entire interest in the activity in a fully taxable transaction to an unrelated party. For more information, see **Pub. 925,** Passive Activity and At-Risk Rules.

Note: *Corporations subject to the passive activity rules must use* ***Form 8810,*** *Corporate Passive Activity Loss and Credit Limitations.*

A Change You Should Note

Worksheets 1 and 2, which are used to figure the amounts to enter on Form 8582, and Worksheets 3 through 6, which are used to figure the allowed and unallowed losses for each activity, are now part of Form 8582. However, the worksheets are not required to be filed and may be detached before filing Form 8582. See the instructions on pages 6 and 7 before completing Form 8582 and Worksheets 1 and 2. After completing Form 8582, see the instructions on page 8 for Worksheets 3 through 6 if you have unallowed passive activity losses.

Who Must File

Form 8582 is filed by individuals, estates, and trusts who have losses (including prior year unallowed losses) from passive activities. You do not have to file Form 8582 if you meet **Exception 1** or **2** below.

Exception 1:

You have an overall gain when you combine all of your net income and net losses (including any prior year unallowed losses) from business or rental passive activities. See definition of overall gain under **Meaning of Terms** on page 2.

In figuring your overall gain or loss from all passive activities for the year, **do not** include the following:

1. Net income that is not passive activity income. See **Passive Activity Income** on page 5.

2. Net losses that are not passive activity net losses. See **Activities That Are Not Passive Activities** on page 3.

3. Net income or net loss from your interest in any publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 9.

4. Any overall loss from an entire disposition of a passive activity. See definition of overall loss under **Meaning of Terms** on page 2. See **Dispositions** on page 6.

Caution: *If you do not have to file Form 8582 because of this exception, write at the top of the form or schedule you are reporting on,* ***"Form 8582 not required due to overall gain from passive activities."***

Exception 2:

You **actively participated** in rental real estate activities (see **Active Participation in a Rental Real Estate Activity** on page 3) and you meet **ALL** of the following conditions:

- Rental real estate activities with active participation were your only passive activities.
- You have no prior year unallowed losses from these activities.
- Your total loss from the rental real estate activities was not more than $25,000 ($12,500 if married filing separately and you lived apart from your spouse all year).
- If you are married filing separately, you lived apart from your spouse all year.
- You have no current or prior year unallowed credits from a passive activity.
- Your modified adjusted gross income was not more than $100,000 ($50,000 if married filing separately and you lived apart from your spouse all year).
- You do not hold any interest in a rental real estate activity as a limited partner or as a beneficiary of an estate or trust.

For the definition of modified adjusted gross income, see the line 6 instructions on page 7.

If you meet all of the conditions listed above, your rental real estate losses are not limited and you do not need to complete Form 8582. For losses reported on line 23, Part I of Schedule E, enter the amount of the loss from line 23 on line 24 of Schedule E. For losses from a partnership or an S corporation, enter the amount of the allowable loss from Schedule K-1 in Part II, column (g), of Schedule E. For losses reported on line 32 of Form 4835, enter the amount of the allowable loss from line 32 on line 33c of Form 4835.

Caution: *If you do not have to file Form 8582 because of this exception, write at the top of Schedule E,* ***"Form 8582 not required because of $25,000 special allowance."***

If you do not qualify for Exception 1 or 2, you must complete Form 8582.

Coordination With Other Limitations

Losses from passive activities generally are subject to other applicable limitations (for example, basis and at-risk limitations) before they are subject to the passive loss limitation. Once a loss becomes allowable under these other limitations, you must determine whether the loss is limited under the passive loss rules. Get **Form 6198,** At-Risk Limitations, for details on the at-risk rules. However, capital losses that are allowable under the passive loss rules, may be limited under section 1211. Similarly, percentage depletion deductions that are allowable under the passive loss rules may be limited under section 613A(d).

Instructions To Read Before Completing Form 8582

To see if your activity is treated as a passive activity, read:

- **Identifying Your Activities** (page 2).

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- **Trade or Business Activities** if your activity is a trade or business activity (page 4).
- **Rental Activities** if your activity is the renting of tangible property (page 3).

To see how to treat income from your activity, read:

- **Passive Activity Income and Deductions, Passive Activity Income, Passive Activity Deductions, Recharacterization of Passive Income,** and **Dispositions** (pages 5 and 6).
- **Phase-In Rule** (page 6).

To see how to enter income and losses on Form 8582, read:

- The instructions for Worksheets 1 and 2 (pages 6 and 7).

Overview of Form

The form consists of three parts.

Part I.—Computation of 1989 Passive Activity Loss. Use Part I to combine the net income and net loss from all passive activities to determine if you have a passive activity loss for 1989.

If the net losses from all passive activities exceed the net income from all passive activities, you will have a passive activity loss for 1989.

Part II.—Computation of the Special Allowance for Rental Real Estate With Active Participation. Use Part II to figure the maximum amount of rental loss allowed if you have a net loss from a rental real estate activity with active participation. (See **Rental Activities** on page 3 for details.)

Part III.—Computation of Passive Activity Loss Allowed. Use Part III to figure the amount of the passive activity loss (as determined in Part I) that is allowed for 1989 for all passive activities.

Meaning of Terms

Except as otherwise indicated, the following terms in these instructions have the meanings shown below:

Net income means the excess of current year income over current year deductions plus any gains from the disposition of assets or an interest in the activity.

Net loss means the excess of current year deductions over current year income plus any current year losses from the disposition of assets or an interest in the activity.

Overall gain means the excess of all net income from the activity over all net losses from the activity. This includes net income or loss from the current year operations of the activity, any gain or loss on a disposition, and any prior year unallowed losses.

Overall loss means the excess of all net losses from the activity over all net income from the activity. This includes net income or loss from the current year operations of the activity, any gain or loss on a disposition, and any prior year unallowed losses.

Prior year unallowed losses means the losses from an activity that were disallowed under the passive activity loss limitations in a prior year and carried forward to the tax year under section 469(b). See Temporary Regulations section 1.469-1T(f)(4) and Pub. 925.

Identifying Your Activities

Generally, each undertaking you own is a separate activity. You can own an undertaking either directly or through a partnership, an S corporation, an estate, or a trust, but not through a C corporation.

An undertaking includes all the business and rental operations you own at the same location either directly or through the same partnership, estate, trust, or S corporation. Operations are conducted at the same location if they are conducted in the same physical structure or within close proximity of one another. Operations not actually conducted at a fixed location are treated as conducted at the location with which they are most closely associated under all the facts and circumstances. For example, if a business sends employees from a central office to perform services at customers' homes, the operations are treated as conducted at the central office. If you conduct all your business and rental operations at the same location directly or through one entity, you have only one undertaking and one activity.

Rental undertakings.—If you own an undertaking that conducts both rental and nonrental operations, you must treat the two types of operations as two separate undertakings unless: (1) the rental operations, if treated as a separate activity, would not be a rental activity (see **Rental Activities** on page 3); or (2) one type of operation predominates over the other (that is, one type of operation produces more than 80 percent of the combined undertaking's gross income).

Combining nonrental undertakings into nonrental activities.—Once you identify your undertakings, treat each undertaking as a separate activity unless one of the following rules requires or permits you to combine undertakings into a larger activity.

Trade or business undertakings.—You generally must combine trade or business undertakings into a larger activity if the undertakings are similar and commonly controlled. For details see Temporary Regulations section 1.469-4T(f) and (j). Trade or business undertakings include all nonrental undertakings except professional service undertakings (described in the next paragraph) and oil or gas wells treated as separate undertakings under Temporary Regulations section 1.469-4T(e). Trade or business activities that constitute an integrated business may have to be combined into a larger activity under Temporary Regulations section 1.469-4T(g).

Professional service undertakings.—Professional service undertakings principally provide services in the fields of health, law, engineering, architecture, accounting, actuarial science, the performing arts, or consulting. Generally, you must combine your interests in professional service undertakings into a single activity if the undertakings provide services in the same field or earn more than 20 percent of their gross income from serving the same customers, or if the undertakings are controlled by the same interests. For details see Temporary Regulations section 1.469-4T(h).

You can elect to treat combined nonrental undertakings as separate activities for purposes other than determining participation in activities. To make this election, you must attach to your return a statement that:

- gives your name, address, and taxpayer identification number;
- declares that the election is being made under section 1.469-4T(o);
- identifies the undertaking you are treating as a separate activity; and
- identifies the rest of the activity from which you are separating the undertaking.

Note: *If undertakings you owned in 1989 would otherwise be combined into a larger activity, you must attach this statement to your 1989 tax return or you will not be able to treat the undertakings as separate activities for 1989 or any later year. For details see Temporary Regulations section 1.469-4T(o).*

Rental real estate undertakings.—In general, each rental real estate undertaking is a separate activity. However, you may combine separate rental real estate undertakings into the same activity. Under certain circumstances, you may also divide a single rental real estate undertaking into separate undertakings. You can then treat each separate undertaking as a separate activity or combine the separate undertakings with other undertakings to identify your rental real estate activities. You generally must attach a statement to your return if you combine separate rental real estate undertakings or portions of undertakings into the same activity or divide a single rental real estate undertaking into separate undertakings.

Note: *If you want to divide a single rental real estate undertaking you owned in 1989 into separate undertakings, you must attach this statement to your 1989 return or you will not be able to treat the undertaking as separate undertakings for 1989 or any later year. For details see Temporary Regulations section 1.469-4T(k).*

Other rental undertakings.—You may not combine or divide your rental undertakings, other than rental real estate undertakings. You must treat each rental undertaking that is not a rental real estate undertaking as a separate activity.

Publicly Traded Partnerships (PTP).—You may not combine operations held through a PTP with any other operations you own, including operations you hold through another PTP. For details see **Publicly Traded Partnerships (PTPs)** on page 9 of the instructions and Temporary Regulations section 1.469-4T(n).

Tax years ending before August 10, 1989.—For tax years ending before August 10, 1989, you may combine your interests in business and rental operations into activities under any reasonable method. For a discussion of reasonable methods, see Notice 88-94, 1988-2 C.B. 419, and Temporary Regulations section 1.469-4T(p). For tax years ending after August 9, 1989, you must use the methods described here and in Temporary Regulations section 1.469-4T. You may, but are not required to, apply the new rules for tax years ending before August 10, 1989. If you have already filed your return for any such year, you can apply the new rules by filing an amended return on **Form 1040X,** Amended U.S. Individual Income Tax Return, or **Form 1041,** U.S. Fiduciary Income Tax Return, whichever applies.

Different rules apply to your activities, depending on their type. There are two kinds of passive activities: trade or business activities in which you did not materially participate for the tax year, and rental activities regardless of your participation. See **Trade or Business Activities** on page 4 and **Rental Activities** below.

Activities That Are Not Passive Activities

The following are not passive activities:

1. Trade or business activities in which you materially participated for the tax year.

2. An interest in an oil or gas well drilled or operated pursuant to a working interest if at any time during the tax year you held the working interest directly or through an entity that did not limit your liability (such as a general partner interest in a partnership). This exception applies regardless of whether you materially participated in the activity for the tax year.

If, however, your liability was not unlimited for the entire year (for example, you converted your general partner interest to a limited partner interest during the year), some of your income and losses from the working interest may be treated as passive activity gross income and passive activity deductions. See Temporary Regulations section 1.469-1T(e)(4)(ii).

3. The rental of a dwelling unit you used as a residence if section 280A(c)(5) applies. This exception applies if you rented out a dwelling unit that you also used as a home during the year for a number of days which exceeds the greater of 14 days or 10 percent of the number of days during the year that the home was rented at a fair rental.

4. An activity of trading personal property for the account of owners of interests in the activity. See Temporary Regulations section 1.469-1T(e)(6).

Low-Income Housing Activities.— Transitional relief is provided for investors in qualified low-income housing projects. Losses from certain investments after 1983 in low-income housing are not treated as from a passive activity for a period of up to 7 years beginning with the year of the original investment. See Pub. 925 for more details. Also see **Passive Activity Income** on page 5.

Income and losses from these activities should not be entered on Form 8582 but may be subject to limitations other than the passive loss rules.

Rental Activities

A rental activity is a passive activity even if you materially participated in the activity.

However, if you meet any one of the six exceptions listed below, the rental of the property is not treated as a rental activity. See **How To Report Income and Losses From the Activities** below if you meet any of the exceptions.

An activity is a rental activity if tangible property (real or personal) is used by customers or held for use by customers and the gross income (or expected gross income) from the activity represents amounts paid (or to be paid) mainly for the use of the property, regardless of whether the use is under a lease, a service contract or some other arrangement that is not called a lease.

Exceptions

An activity is not a rental activity if:

1. The **average period of customer use** of the rental property is seven days or less.

Figure the **average period of customer use** for a class of property by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Temporary Regulations section 1.469-1T(e)(3)(iii).

2. The **average period of customer use** (see definition in 1 above) of the rental property is 30 days or less and **significant personal services** were provided in connection with making the rental property available for customer use.

Significant personal services include only services performed by individuals. In determining whether personal services are significant, all of the relevant facts and circumstances are taken into consideration. Facts and circumstances include the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for use of the property.

3. **Extraordinary personal services** were provided in connection with making the rental property available for customer use.

Services provided in connection with making rental property available for customer use are **extraordinary** personal **services** only if the services are performed by individuals and the customers' use of the rental property is incidental to their receipt of the services.

4. The rental of the property is **incidental** to a nonrental activity.

The rental of property is **incidental** to an activity of holding property for investment if the main purpose of holding the property is to realize a gain from the appreciation of the property and the gross rental income is less than 2% of the smaller of the **unadjusted basis** of the property or the fair market value of the property.

Unadjusted basis means the cost of the property without regard to depreciation deductions or any other adjustment described in section 1016 that reduces basis.

The rental of property is **incidental** to a trade or business activity if:

a. You own an interest in the trade or business activity at all times during the year;

b. The rental property was mainly used in the trade or business activity during the tax year or during at least two of the five preceding tax years; and

c. The gross rental income from the property is less than 2% of the smaller of the **unadjusted basis** of the property or the fair market value of the property.

Lodging provided for the employer's convenience to an employee or the employee's spouse or dependents is **incidental** to the activity or activities in which the employee performs services.

5. You customarily make the rental property available during defined business hours for nonexclusive use by various customers.

6. You provide property for use in a nonrental activity of a partnership, an S corporation, or a joint venture in your capacity as an owner of an interest in such partnership, S corporation, or joint venture.

For example, if a partner contributes the use of property to a partnership, none of the partner's distributive share of partnership income is income from a rental activity unless the partnership is engaged in a rental activity. In addition, a partner's gross income attributable to a guaranteed payment under section 707(c) is not income from a rental activity. The determination of whether the property used in the activity is provided in the partner's capacity as an owner of an interest in the partnership is made on the basis of all the facts and circumstances.

How To Report Income and Losses From the Activities

If you meet any of the six exceptions listed above, your rental of the property is not a rental activity. You must then determine whether your rental of the property is a trade or business activity and, if so, whether you materially participated in the activity for the tax year (see **Trade or Business Activities** on page 4). If the activity is a trade or business activity in which you did not materially participate, enter the income and losses from the activity in Worksheet 2 on page 3 of Form 8582.

If you meet any of the six exceptions listed above and the activity is a trade or business activity in which you materially participated, report any income or loss from the activity on the forms or schedules you normally use.

If you **did not** meet any of the six exceptions, the rental activity is a passive activity. Special rules apply if you conduct the rental activity through a publicly traded partnership (PTP) or if any of the rules described under **Recharacterization of Passive Income** on page 5 apply. See the PTP rules on page 9.

If none of the special rules apply, the rental activity is entered on either Worksheet 1 or 2 on page 3 of Form 8582. Worksheet 1 is for rental real estate activities in which you actively participated. See **Active Participation in a Rental Real Estate Activity** below. Worksheet 2 is for rental real estate activities in which you did not actively participate, activities of renting personal property, and other trade or business activities in which you did not materially participate. See the instructions for Worksheets 1 and 2 on pages 6 and 7.

Active Participation in a Rental Real Estate Activity

If you actively participated in a rental real estate activity, you may be able to deduct up to $25,000 of the loss from the activity from nonpassive income. This "special allowance" is an exception to the general rule disallowing losses in excess of income from passive activities. The exception is not available if you were married for the tax year, file a

separate return for the year, and did not live apart from your spouse at all times during the year.

Only individuals and qualifying estates can actively participate in a rental real estate activity. Estates (other than qualifying estates) and trusts cannot actively participate. Limited partners cannot actively participate unless future regulations provide an exception.

You are not considered to actively participate in a rental real estate activity if at any time during the tax year your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation (see **Material Participation,** below). You may be treated as actively participating if you participated, for example, in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that can count as active participation include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions.

An estate is treated as actively participating for tax years ending less than 2 years after the date of the decedent's death if the decedent would have satisfied the active participation requirements for the activity for the tax year the decedent died. Such an estate is a "qualifying estate."

The maximum special allowance that single individuals and married individuals filing a joint return for the tax year can qualify for is $25,000. The maximum is $12,500 in the case of married individuals who file separate returns for the tax year and who lived apart at all times during the tax year. The maximum special allowance for which an estate can qualify is $25,000 reduced by the special allowance for which the surviving spouse qualified. Any phase-in of the surviving spouse's allowance is disregarded in computing the estate's maximum allowance.

If your modified adjusted gross income is $100,000 or less ($50,000 or less in the case of married persons filing separately), your loss is deductible up to the amount of the maximum special allowance referred to in the preceding paragraph. If your modified adjusted gross income is more than $100,000 ($50,000 in the case of married persons filing separately), the special allowance is 50% of the difference between $150,000 ($75,000 in the case of married persons filing separately) and your modified adjusted gross income. When modified adjusted gross income is $150,000 ($75,000 in the case of married persons filing separately) or more, there is no special allowance.

If you qualify under the active participation rules, use Worksheet 1 on page 3 of Form 8582 and see page 8 of the instructions.

Trade or Business Activities

An activity is a trade or business activity if the activity is not a rental activity and involves the conduct of business and rental operations that are not incidental to an activity of holding property for investment.

"Business and rental operations" are endeavors you engage in for profit or the production of income that satisfy one or more of the following conditions:

a. They involve the conduct of a trade or business (i.e., deductions would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply) or are conducted in anticipation of the endeavors becoming a trade or business;

b. They involve making tangible property available for use by customers; or

c. Research or experimental expenditures in the activity are deductible under section 174 (or would be if you chose to deduct rather than capitalize them).

Trade or business activities are generally reported on Schedule C or F, or on Part II or III of Schedule E.

Material Participation

Individuals.—You materially participated for the tax year in a trade or business activity if you satisfy one or more of the following tests:

1. You participated in the activity for more than 500 hours.

2. Your participation in the activity for the tax year was substantially all of the participation in the activity of all individuals (including individuals who did not own any interest in the activity) for the year.

3. You participated in the activity for more than 100 hours during the tax year, and you participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.

4. The activity is a significant participation activity for the tax year, and you participated in all significant participation activities during the year for more than 500 hours. A **significant participation activity** is any trade or business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation tests (other than this test 4).

5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 preceding tax years. When determining whether you materially participated in tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year.

6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. When determining whether you materially participated for tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year.

An activity is a personal service activity if it involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business, in which capital is not a material income-producing factor.

7. Based on all of the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

You did not materially participate in the activity under this seventh test, however, if You participated in the activity for 100 hours or less during the year. Your participation in managing the activity does not count in determining whether you materially participated under this test if:

a. Any person (except you) received compensation for performing services in the management of the activity; or

b. Any individual spent more hours during the tax year than you spent performing services in the management of the activity (regardless of whether the individual was compensated for the management services).

Caution: *Future regulations will provide additional rules for determining whether you materially participated under the seventh test.*

Participation.—Participation for purposes of the material participation test generally includes any work you did (without regard to the capacity in which you did it) in connection with an activity in which you owned an interest at the time you did the work. Work is not treated as participation, however, if the work is not work that an owner of that type of activity would customarily do, and one of your main purposes for doing the work was to avoid the disallowance of losses or credits from the activity under the passive loss rules.

Work you did as an investor in an activity is not treated as participation unless you were directly involved in the day-to-day management or operations of the activity. Work done as an investor includes:

a. Studying and reviewing financial statements or reports on operations of the activity.

b. Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use.

c. Monitoring the finances or operations of the activity in a nonmanagerial capacity.

Participation of spouse.—If you are married for the tax year, your participation in an activity includes any participation in the activity during the tax year by your spouse, whether or not your spouse owned any interest in the activity and whether or not you and your spouse file a joint return for the tax year.

Proof of participation.—You may prove your participation in an activity by any reasonable means. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation by other reasonable means. Reasonable means for this purpose may include, but are not limited to, the identification of services performed over a period of time and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

Limited partners.—If you owned your interest in an activity as a limited partner, you generally **did not** materially participate in the activity. You **did** materially participate in the activity, however, if you materially participated in the activity under test 1, 5, or 6 above for the tax year.

You are not treated as a limited partner, for purposes of the material participation tests, however, if you were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter, during the portion of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

Certain retired or disabled farmers and surviving spouse of farmers.—Certain retired or disabled farmers and surviving spouses of farmers are treated as materially participating in a farming activity if the real property used in the activity would meet the estate tax rules for special valuation of farm property passed from a qualifying decedent. See Temporary Regulations section 1.469-5T(h)(2).

Estates and trusts.—The passive loss limitations apply in computing the distributable net income and taxable income of an estate or trust. See Temporary Regulations section 1.469-1T(b)(2) and (3). Future regulations will explain how to determine material participation for this purpose.

How To Report Income and Losses From Trade or Business Activities

Trade or business activities with material participation.—If you materially participated in a trade or business activity, the activity is **not** a passive activity. Report the income and losses from the activity on the form or schedule you normally use.

Trade or business activities without material participation.—If you did not materially participate in a trade or business activity, the activity is a passive activity. In general, you must use Worksheet 2 on page 3 of Form 8582 to determine the amount to enter on Form 8582. However, if you owned the activity through a publicly traded partnership or the activity is a significant participation activity, special rules apply. See **Publicly Traded Partnerships (PTPs)** on page 9. See Pub. 925 for how to report income or losses from significant participation passive activities.

Passive Activity Income and Deductions

Take into account only passive activity income and passive activity deductions in determining your net income or net loss from all passive activities or any passive activity. For example, if your passive activity is reported on Schedule C, E, or F, and the activity has no prior year unallowed losses or any gain or loss from the disposition of assets or an interest in the activity, take into account only the passive activity income and passive activity deductions from the activity in determining the amount to enter on Form 8582 and the worksheets.

If you own an interest in a passive activity through a partnership or an S corporation, the partnership or S corporation will generally provide you with the net income or net loss from the passive activity. If, however, the partnership or S corporation is required to state an item of gross income or deduction separately to you, and the gross income or deduction is passive activity gross income or a passive activity deduction (respectively), you must include that amount in computing the net income or net loss entered on Form 8582 and the worksheets.

Caution: *The partnership or S corporation does not have a record of any prior year unallowed losses from the passive activities of the partnership or S corporation. If you had prior year unallowed losses from this activity, they can be found in column (c) of your 1988 Worksheet 4.*

Passive Activity Income

In determining your overall gain or loss (see **Meaning of Terms** on page 2) from all passive activities or any passive activity, take into account only passive activity income. Do not enter income that is not passive activity income on Form 8582 or the worksheets. Passive activity income includes all income from passive activities, including (with certain exceptions described in Temporary Regulations section 1.469-2T(c)(2)) gain from the disposition of an interest in a passive activity or property used in a passive activity at the time of the disposition.

Passive activity income **does not** include the following:

- Income from an activity that is not a passive activity. See **Activities That Are Not Passive Activities** on page 3.
- Portfolio income, including interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business and gain or loss from the disposition of property that produces those types of income or is held for investment (see section 163(d)(5)). See Temporary Regulations section 1.469-2T(c)(3).
- Personal service income, including salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated for the tax year, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services. See Temporary Regulations section 1.469-2T(c)(4).
- Income from positive section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(c)(5).
- Income or gain from investments of working capital.
- Income from an oil or gas property if you treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss under the rule, excluding working interests in oil and gas wells from passive activities. See Temporary Regulations section 1.469-2T(c)(6).
- Any income from intangible property if your personal efforts significantly contributed to the creation of the property.
- Income from a qualified low-income housing project (see section 502 of the Tax Reform Act of 1986) for any year in which losses from the project would not be subject to the passive loss limitations under the special transitional rule for certain low-income housing projects.
- Any income treated as income that is not passive activity income under Temporary Regulations section 1.469-2T(f). See **Recharacterization of Passive Income** below.
- Overall gain from any interest in a publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 9.
- State, local, and foreign income tax refunds.
- Income from a covenant not to compete.

Passive Activity Deductions

In determining your overall gain or overall loss from all passive activities or any passive activity, take into account only passive activity deductions. Do not take into account deductions that are not passive activity deductions. Passive activity deductions include all deductions from activities that are passive activities for the tax year and all deductions from passive activities that were disallowed under the passive loss rules in prior tax years beginning after 1986 and carried forward to the tax year under section 469(b). See Temporary Regulations section 1.469-1T(f)(4).

Passive activity deductions include losses from dispositions of property used in a passive activity at the time of the disposition and losses from a disposition of less than your entire interest in a passive activity. See **Dispositions** on page 6 for the treatment of losses upon certain dispositions of your entire interest in an activity.

Passive activity deductions **do not** include the following:

- Deductions for expenses (other than interest expense) that are clearly and directly allocable to portfolio income.
- Dividends received deductions for dividends not included in passive activity gross income.
- Interest expense, other than interest expense properly allocable under Temporary Regulations section 1.163-8T to passive activities (for example, qualified home mortgage interest and capitalized interest expense are not passive activity deductions).
- Losses from dispositions of property that produce portfolio income or property held for investment.
- State, local, and foreign income taxes.
- Miscellaneous itemized deductions that may be disallowed under section 67.
- Charitable contribution deductions.
- Net operating loss, percentage depletion, and capital loss carryovers.
- Deductions and losses that would have been allowed for tax years beginning before 1987, but for basis or at-risk limitations.
- Net negative section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(d)(7).

Recharacterization of Passive Income

Certain income from passive activities may be recharacterized and excluded from passive activity income. The amount of income recharacterized equals the net income from the sources below. If during the tax year you received net income from

any sources described below (either directly or through a partnership or an S corporation), get Pub. 925 to see how to report net income or loss from these sources. Also see Temporary Regulations section 1.469-2T(f) for more information.

Income from the following sources may be subject to the net income recharacterization rules:

- Significant participation passive activities. A significant participation passive activity is any trade or business activity (as defined on page 4) in which you participated for more than 100 hours during the tax year and did not materially participate (see **Material Participation** on page 4 and Pub. 925).
- Rental of property when less than 30 percent of the unadjusted basis of the property is subject to depreciation under section 167.
- Passive equity-financed lending activities.
- Rental of property incidental to a development activity.
- Rental of property to a nonpassive activity.
- Acquisition of an interest in a passthrough entity that licenses intangible property.

Dispositions

Disposition of less than an entire interest.—Gains and losses from the disposition of less than an entire interest in an activity are treated as part of the net income or loss from the activity for the current year and are to be included on Form 8582. A disposition of less than an entire interest does not trigger the allowance of prior year unallowed losses. See the instructions for Part I and the instructions for Worksheets 1 and 2 on pages 6 and 7 for how to make the entries on Form 8582.

Disposition of an entire interest.—If you disposed of your entire interest in a passive activity or a former passive activity to an unrelated person in a fully taxable transaction during the tax year, your losses allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is a transaction in which you recognize all of your realized gain or loss.

Note: *The operations you treat as your entire interest in an activity for purposes of this disposition rule may depend on whether you have elected to treat certain nonrental undertakings as separate activities or whether you have treated certain rental real estate undertakings as separate undertakings. See* ***Identifying Your Activities*** *on page 2 of the instructions and Temporary Regulations section 1.469-4T(k) and (o).*

Note: *A partner in a publicly traded partnership (PTP) is not treated as having disposed of an entire interest in an activity of a PTP until there is an entire disposition of the partner's interest in the PTP.*

Reporting an entire disposition on Schedule D or Form 4797.—When you completely dispose of your entire interest in a passive activity, you may have to report net income or loss and prior year unallowed losses from the activity. All of the net income and losses are reported on the forms and schedules you normally use.

Combine any income and losses (including any prior year unallowed losses) from the activity for the tax year to see if you have an overall gain or loss. If you have an overall gain and you have other passive activities to report on Form 8582, include the income, losses and prior year unallowed losses in Worksheet 1 or 2. If this is your only passive activity, report any income and losses (including any prior year unallowed losses) on the forms and schedules you normally use and skip the worksheets and Form 8582.

If you have an overall loss when you combine the income and losses, do not use the worksheets or Form 8582 for the activity. Any losses (including prior year unallowed losses) are allowed in full. Report the income and losses on the forms and schedules you normally use.

If you must figure modified adjusted gross income for line 6 of Form 8582, the overall loss from this activity is a nonpassive activity loss and must be used when computing modified adjusted gross income. This is because an overall loss (see **Meaning of Terms** on page 2) from an entire disposition of a passive activity is a nonpassive loss when there is an aggregate loss from all other passive activities.

Example 1: Activity with overall gain

You sell your entire pre-enactment interest in a rental property in which you actively participated at a gain of $15,525. $7,300 of the gain is section 1231 gain (Form 4797, Part I) and $8,225 is ordinary recapture income (Form 4797, Part II). The total loss to be reported on line 24 of Schedule E (Form 1040) is ($15,450). This includes a current year ($2,800) net loss, and a ($12,650) prior year unallowed loss.

If you had other passive activities reportable on Form 8582, the following entries would be made in Worksheet 1, Part 1, on page 3 of Form 8582. The $15,525 gain on the disposition is entered in column (a), the current year loss of ($2,800) is entered in column (b), and the prior year unallowed loss of ($12,650) is entered in column (c).

Example 2: Activity with overall loss

You sell your entire interest in a limited partnership. You have a Schedule E net loss of ($3,330), a Schedule E prior year unallowed loss of ($1,115), and a Schedule D gain of $2,000 on the sale of your interest in the partnership.

Since there is an overall loss of ($2,445) after combining the gain and losses, none of the amounts are entered in Worksheet 2 or on Form 8582.

The net loss plus the prior year unallowed loss ($3,330 + $1,115 = $4,445) is entered on Schedule E, Part II, column (i), and the $2,000 gain on the sale is entered on Schedule D, in either Part I or Part II, depending on how long the partnership interest was held.

Phase-In Rule

For tax years 1987 through 1990, the passive activity loss limitations are phased-in by allowing a declining percentage of the losses from pre-enactment interests in passive activities (net of any losses allowed under the $25,000 allowance for active participation rental real estate activities). The percentage for tax years beginning in 1989 is 20 percent.

A pre-enactment interest is a qualified interest in a pre-enactment activity. Your interest in an undertaking is treated as a qualified interest in an activity if for 1989 the undertaking continues business and rental operations of an undertaking that you held on October 22, 1986, and have held at all times since that date, or that you acquired after October 22, 1986, under one or more written binding contracts you were a party to on October 22, 1986, and have held at all times since you acquired the interest. See **Identifying Your Activities** on page 2 for rules for identifying activities.

An activity is a pre-enactment activity if any of the business and rental operations that are part of the activity continue business and rental operations that any person was conducting on October 22, 1986, or at least 50 percent (by value) of the property used in the activity during the tax year was either in existence or under construction on August 16, 1986, or acquired or constructed by any person under a written binding contract in effect on August 16, 1986.

In Worksheets 1 and 2, report income and loss from pre-enactment interests separately from post-enactment interests in activities. See Temporary Regulations section 1.469-11T(c) for more information on pre-enactment interests and the phase-in rule.

Note: *Form 8582 and the instructions refer to* ***"Activities acquired before 10-23-86 (pre-enactment)"*** *and* ***"Activities acquired after 10-22-86 (post-enactment)."*** *The term* ***"activity acquired before 10-23-86 (pre-enactment)"*** *means a pre-enactment interest in an activity, and the term* ***"activity acquired after 10-23-86 (post-enactment)"*** *means a post-enactment interest in an activity.*

Specific Instructions

Part I

Worksheet 1

The $25,000 allowance applies to losses from rental real estate activities. (See **Active Participation in a Rental Real Estate Activity** on page 3.) To be a "rental real estate activity," the activity must be a "rental activity" (see **Rental Activities** on page 3). For example, if the average period of customer use of the rental property is 7 days or less, the activity is not a rental activity or a rental real estate activity, and none of the losses from the activity qualify for the $25,000 allowance even if you actively participated in the activity. If this is the case, and if you do not meet any of the

material participation tests under **Trade or Business Activities** on page 4, enter the income and losses from the activity on Worksheet 2, not on Worksheet 1.

Caution: *Do not enter a prior year unallowed loss in column (c) of Worksheet 1 unless you actively participated in the activity in both the year the loss arose and the current tax year. If you did not actively participate in both years, enter the prior year unallowed loss in column (c) of Worksheet 2.*

Individuals and qualifying estates who actively participated in rental real estate activities should use Worksheet 1 and include the income or loss from those activities on lines 1a through 1h of Form 8582. Read **Active Participation in a Rental Real Estate Activity** on page 3 of the instructions to see if you actively participated. Use Worksheet 1 to figure the amounts to enter on lines 1a, 1b, 1d, 1e, and 1h if you actively participated in a rental real estate activity. Use Worksheet 2 to figure amounts to enter on lines 2a, 2b, 2d, 2e, and 2h if you did not actively participate in a rental real estate activity.

Caution: *Married individuals who are filing separate returns and did not live apart from their spouse at all times during the tax year do not qualify under the active participation rule and should use Worksheet 2 instead of Worksheet 1.*

Use Part 1 for pre-enactment interests and Part 2 for post-enactment interests.

See Pub. 925 for an example showing how to complete the worksheet.

Column (a).—Enter the net income and gain from each activity. For example, if a Schedule C activity has current year profit of $5,000 and a Form 4797 gain of $2,000, enter $7,000 in column (a). Enter the total of column (a), Part 1, on line 1a of Form 8582. Enter the total of column (a), Part 2, on line 1d of Form 8582.

Column (b).—Enter the net loss for each activity. For example, if a Schedule E rental activity has a current year loss of ($4,500) on line 23 of Schedule E and a current year Form 4797 loss of ($1,000), enter ($5,500) in column (b). Do not enter any prior year unallowed losses in this column. Enter the total of column (b), Part 1 on line 1b of Form 8582. Enter the total of column (b), Part 2, on line 1e of Form 8582.

Column (c).—Enter the prior year unallowed losses for each activity. These amounts can be found in Worksheet 4, column (c), of your 1988 Form 8582 instructions. Enter the total of column (c) from your 1989 Worksheet 1 for both Parts 1 and 2, on line 1h of Form 8582.

Columns (d) and (e).—Combine income and losses in columns (a) through (c) for each activity and enter any overall gain for the activity in column (d) or any overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Worksheet 2

Use Worksheet 2 for trade or business activities in which you did not materially participate, for rental real estate activities that do not qualify for the special allowance, and for rental activities other than rental real estate activities.

Use Part 1 for pre-enactment interests and Part 2 for post-enactment interests.

Pub. 925 has examples of a completed Form 8582 and worksheets.

Column (a).—Enter the net income for each activity. (See the example included in the instructions under column (a) for Worksheet 1, above.) Enter the total of column (a), Part 1, on line 2a of Form 8582. Enter the total of column (a), Part 2, on line 2d of Form 8582.

Column (b).—Enter the net loss for each activity. (See the example included in the instructions under column (b) of Worksheet 1, above.) Enter the total of column (b), Part 1 on line 2b of Form 8582. Enter the total of column (b), Part 2 on line 2e of Form 8582.

Column (c).—Enter the prior year unallowed losses for each activity. These amounts can be found in Worksheet 4, column (c) of your 1988 Form 8582 instructions. Enter the total of column (c) from your 1989 Worksheet 2 for both Parts 1 and 2, on line 2h of Form 8582.

Columns (d) and (e).—Combine income and losses in columns (a) through (c) for each activity and enter any overall gain for the activity in column (d) or any overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

Line 3.—If line 3 shows income, all of your losses are allowed including any prior year unallowed losses entered on line 1h or 2h. Take the losses to the form or schedule you normally report them on. See page 8 for how to report the losses on the different forms and schedules.

Parts II and III

Treat all numbers entered in Parts II and III as positive (that is, greater than zero).

Examples:

1. Line 1i has a loss of $47,000 and line 3 has a loss of $42,000. Enter $42,000 as a positive number on line 4.

2. Line 4 has a loss of $42,000 and line 8 is $25,000. Enter $25,000 as a positive number on line 9.

3. Line 1c has a loss of $37,000 and line 8 is $25,000. Enter $25,000 as a positive number on line 11.

4. Line 10 is $32,000 and line 11 is $25,000. When subtracting line 11 from line 10, the amount to enter on line 12 is $7,000. Enter it as a positive number.

Line 5.—Married persons filing separate returns who lived apart at all times during the year should enter $75,000 on line 5 instead of $150,000. Married persons filing separate returns who lived together at any time during the year are not eligible for the Special Allowance. They must enter -0- on lines 8 and 9 and go to line 10.

Line 6.—To figure modified adjusted gross income for this line, combine all of the amounts you would enter if you were figuring adjusted gross income for your tax return, but do not include the taxable amount of social security and tier I railroad retirement benefits, or the allowable deduction under section 219 for contributions to IRAs and certain other qualified retirement plans. In addition, do not include any passive income or loss included on Form 8582 or any overall loss from a PTP.

Include portfolio income or expenses that are clearly and directly allocable to portfolio income in the modified adjusted gross income computation. Any income that is treated as nonpassive income is included in the computation of modified adjusted gross income. For example, overall gain from a publicly traded partnership and net income from an activity or item of property subject to the recharacterization of passive income rules is nonpassive income. In addition, an overall loss from the entire disposition of a passive activity is not included on Form 8582, but the overall loss is a nonpassive loss and must be included in the computation of modified adjusted gross income.

Example.—If your adjusted gross income on line 32 of Form 1040 is $92,000, and you had taxable social security benefits of $5,500 on line 21b, your modified adjusted gross income would be $86,500 ($92,000 minus $5,500).

Line 8.—Do not enter more than $12,500 on line 8 if you are married filing a separate return and you and your spouse lived apart at all times during the year. Married persons filing separate returns who lived together at any time during the year are not eligible for the special allowance. They must enter -0- on lines 8 and 9 and go to line 10.

Line 10.—Combine lines 1c and 2c and enter the result. If the result is -0- or income, skip to line 16. See Pub. 925 if you have a pre-enactment loss from a significant participation passive activity.

Line 12.—You may have to adjust the amount you get after subtracting line 11 from line 10 if you had activities that were subject to the recharacterization of passive income rules. See Pub. 925.

Line 19.—Use the worksheets on page 4 of Form 8582 and the instructions for those worksheets on page 8 to figure the unallowed loss to be carried forward and the allowed loss to report on the forms and schedules for 1989. Worksheets 1 and 2, columns (d) and (e), will show whether an activity had an overall gain or loss. If you have activities that show overall gain in column (d) of Parts 1 or 2 of Worksheet 1 or 2, report all of the income and losses listed in columns (a), (b), and (c) for those activities on the proper forms and schedules.

If you have activities in Worksheet 1 or 2 that show an overall loss in column (e), you will have to allocate the allowed loss on line 19 of Form 8582 to those activities by completing Worksheets 3, 4, and 5 or 6.

Start with Worksheet 3 if you have any activities in Worksheet 1 with an overall loss in column (e) and an amount on line 9 of Form 8582. If you do not have activities with an overall loss in Worksheet 1 or line 9 does

not have an entry, start with Worksheet 4 for any activities in Worksheet 1 or 2 that show an overall loss in column (e).

Worksheet 3

Use Worksheet 3 if you have activities in Worksheet 1 with an overall loss in column (e) and an amount on line 9 of Form 8582.

Column (a).—Enter the overall loss from column (e) of Worksheet 1 for each activity.

Column (b).—Divide each of the individual losses shown in column (a) by the total of all of the losses in column (a) and enter the ratio for each of the activities in column (b). The total of all of the ratios should equal 1.00.

Column (c).—Multiply line 9 of Form 8582 by each of the ratios in column (b) and enter the results in column (c). The total of column (c) should be the same as line 9 of Form 8582.

Column (c) total is the same as column (a) total.—If the total losses in column (c) are the same as the total losses in column (a), all of the amounts in columns (a), (b), and (c) of Worksheet 1 should be reported on the proper forms and schedules. The losses in Worksheet 1 are allowed in full and are not carried over to Worksheet 4. Complete Worksheet 4 only if you have activities with overall losses in column (e) of Worksheet 2.

Column (c) total is less than column (a) total.—If the total losses in column (c) are less than the total losses in column (a), complete column (d).

Column (d).—Subtract column (c) from column (a) and enter the results in this column. Also enter on Worksheet 4 the name of the activities and the form or schedule on which the loss is to be reported. Enter the amounts from column (d) of this worksheet in column (a) of Worksheet 4. Also include in Worksheet 4 any activities from Worksheet 2 that have an overall loss in column (e) of that worksheet.

Worksheet 4

Complete Worksheet 4 if you have an overall loss in column (e) of Worksheet 2 or losses in column (d) of Worksheet 3 or column (e) of Worksheet 1, if you did not have to complete Worksheet 3.

Column (a).—Enter the amounts, if any, from column (d) of Worksheet 3 or column (e) of Worksheet 1, if you did not have to complete Worksheet 3 and the losses, if any, shown in Parts 1 and 2, column (e) of Worksheet 2.

Column (b).—Divide each of the individual losses shown in column (a) by the total of all of the losses in column (a) and enter the ratio for each of the activities in column (b). The total of all of the ratios should equal 1.00.

Column (c).—Complete the following computation:

A. Enter line 3 of Form 8582 _____

B. Enter line 17 of Form 8582 _____

C. Subtract line B from line A _____

Multiply line C by the ratios in column (b) and enter the results in column (c).

Use Worksheet 5 for the activities listed in Worksheet 4 if all of the loss from the same activity is reported on one form or schedule. For example, use Worksheet 5 if all of the loss from the activity is reported on Schedule E, even though part of the loss may be a current year Schedule E loss and part of it may be from a Schedule E prior year unallowed loss.

If you have losses from the same activity that are to be reported on two or more different schedules, use Worksheet 6 instead of Worksheet 5 for those activities. For example, if you have a Schedule C loss and you also have a Form 4797 loss from the sale of assets from the Schedule C activity, you should use Worksheet 6 instead of Worksheet 5.

Worksheet 5

Column (a).—Enter the activities shown in Worksheet 4 if all of the loss from the same activity is to be reported on one form or schedule. The loss to enter in column (a) of this worksheet is the net loss plus the prior year unallowed loss for each activity you enter in this worksheet. This amount can be found by adding the losses in columns (b) and (c) in Parts 1 and 2 of Worksheets 1 and 2.

Column (b).—Enter the amounts from column (c) of Worksheet 4 for the activities listed in this worksheet. These are your **unallowed losses for 1989.** Keep a record of these amounts so the losses can be used to figure your passive activity loss next year.

Column (c).—Subtract column (b) from column (a). These are the **losses allowed for 1989.** The amounts in this column should be reported on the form or schedule you normally use.

See the forms and schedules listed under **How To Report Allowed Losses on the Forms and Schedules** below. **Pub. 925** also has an extensive example of how to report passive income and losses on the forms and schedules.

Worksheet 6

Use Worksheet 6 if you have losses from the same activity that are reported on two or more different forms and schedules. Worksheet 6 will allocate the loss allowed and unallowed for the activity and the loss allowed on the different forms or schedules used to report the losses. Only the losses that would cause a difference in the tax liability if they were reported on a different form or schedule are kept separate. Any losses from the following forms or schedules should be kept separate:

- Schedules C, D (Parts I and II), E, and F.
- Forms 4684 (Section B), 4797 (Parts I and II), and Form 4835.

You should make a copy of Worksheet 6 to use for each additional activity for which you have losses reported on two or more different forms or schedules.

When making entries in Worksheet 6, enter the name of the form or schedule on the line above line 1a.

Line 1a, column (a).—The amount to enter on this line is the net loss plus any prior year unallowed loss from the activity that goes on the same form, or in the case of Schedule D and Form 4797, the same part (Part I or Part II).

Line 1b, column (a).—Enter any net income from the activity that goes on the same form or schedule as the loss on line 1a, column (a). For example, you entered a prior year loss from Form 4797, Part I, on line 1a and this year you have a current year gain that is also reported on Form 4797, Part I. Enter the gain on line 1b, column (a). If the activity did not have a Form 4797, Part I gain, -0- would be entered on line 1b, column (a).

Line 1c, column (b).—Subtract line 1b, column (a) from line 1a, column (a), and enter the result in column (b). If line 1b, column (a) is more than line 1a, column (a), enter -0- in column (b).

Column (c).—Divide each of the losses entered in column (b) by the total of column (b) and enter the ratio in this column. The total of this column should be 1.00.

Column (d).—Find the unallowed loss for this activity in Worksheet 4, column (c), and multiply that unallowed loss by the ratio in column (c) of this worksheet. If you have entries in column (b) of this worksheet that show -0-, also enter -0- for that form or schedule in this column.

The amount in this column is the **unallowed loss for 1989.** Keep a record of this worksheet so that you can use the losses to figure your passive activity loss next year.

Column (e).—Subtract the amount in column (d) from the loss entered on line 1a, column (a). This is the **allowed loss for 1989** to be entered on the forms or schedules. The forms and schedules you report on should show the losses from this column and the income, if any, for that activity from column (a) of Worksheet 1 or 2.

See the forms and schedules listed under **How To Report Allowed Losses on the Forms and Schedules** below. Pub. 925 also has an extensive example of how to report passive income and losses on the forms and schedules.

How To Report Allowed Losses on the Forms and Schedules

Line 3 is income.—If line 3 of Form 8582 was income, all of the losses in columns (b) and (c) of Worksheets 1 and 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheets 1 and 2 on the forms and schedules normally used.

Line 19 is the same as the total of lines 1b, 1e, 1h, 2b, 2e, and 2h.—If this is the case, all of the losses in columns (b) and (c) of Worksheets 1 and 2 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheets 1 and 2 on the forms and schedules normally used.

Columns (a) and (c) of Worksheet 3 are the same amount.—If this is the case, all of the losses in columns (b) and (c) of Worksheet 1 are allowed in full. Report the income and losses in columns (a), (b), and (c) of Worksheet 1 on the forms and schedules normally used.

Losses allowed in column (c) of Worksheet 5.—The amounts shown in column (c) of Worksheet 5 are the losses allowed for 1989 for the activities listed in that worksheet. Report the loss allowed from column (c) of Worksheet 5 and the income, if any, for that activity shown in column (a) of Worksheet 1 or 2, on the form or schedule normally used.

Losses allowed in column (e) of Worksheet 6.—The amount shown in column (e) of Worksheet 6 are the losses allowed for 1989 for the activity listed in that worksheet. Report the losses on the form or schedule and the income, if any, for that activity shown in column (a) of Worksheet 1 or 2, on the form or schedule normally used.

Schedules C, F, and Form 4835.—Enter on the net profit or loss line of your schedule or form, the allowed passive activity loss from the worksheet. To the left of the entry space write, **PAL**.

If the net profit or loss line on your form or schedule showed net profit for the year, reduce the net profit by the allowed loss from Worksheet 5 or 6 and enter the result on the net profit or loss line. For example, Schedule C shows net profit for the year of $5,000. The activity also has a Form 4797 gain of $2,500 and a prior year unallowed Schedule C loss of ($6,000). The loss allowed for 1989 is ($6,000). Line 30 of Schedule C would show $5,000 less the loss allowed of ($6,000) for a net loss of ($1,000). To the left of the entry space, write **PAL**.

See Schedule D and Form 4797 instructions below if you also had passive gains and losses from the sale of assets or an interest in the passive activity.

Schedule E, Part I.—Enter the allowed loss from the worksheet on line 24 of Schedule E. An activity that has net profit for the year and prior year unallowed losses will have net profit on line 23 and the allowed loss on line 24. The allowed loss on line 24 will include the loss allowed to the extent of the net profit. Line 25 of Schedule E will show total net profit and line 26 will show total losses allowed (both passive and nonpassive). Line 27 will show the total net profit or loss.

Schedule E, Parts II and III.—Any net income shown on your Schedule K-1 that is passive income should be entered as passive income in the appropriate column of Schedule E, Part II or III. Enter the passive loss allowed from Worksheet 5 or 6 in the appropriate column for passive losses. The passive losses allowed include the loss allowed to the extent of any net income from the activity. See Schedule D and Form 4797 instructions below if you also had passive gains or losses from the sale of assets or an interest in the passive activity.

Form 4684, Section B.—Any passive activity gain from Form 4684 remains unchanged. It was used on Form 8582 to determine allowable passive activity losses. If you did not have passive activity losses on Form 4684, complete Form 4684 and follow the instructions for that form for where to report the gain.

If you had passive activity losses from Form 4684, cross through the amount you first entered in Section B on line 13, 14, 20a, 20b, or 21 and show the allowed loss from the worksheet. To the left of the entry space, write **PAL**.

Schedule D and Form 4797.—If you sold assets from a passive activity or if you sold an interest in your passive activity, all gains from the activities should be shown on the appropriate line of Schedule D or Form 4797. Identify the gain as **"From passive activity."** Enter any allowed losses for Schedule D or Form 4797 on the appropriate line and to the left of the entry write **PAL**.

Entire disposition with an overall loss.—If you had an entire disposition of your interest in a passive activity and that activity had an overall loss (see **Meaning of Terms** on page 2), none of the gains, if any, or losses should have been entered on Form 8582 or the worksheets. However, all of the gains and losses should be reported on the forms or schedules you normally use. Write to the left of the entry space, **"Entire disposition of passive activity."**

Entire disposition with an overall gain.—Gains and losses from this activity were included on Form 8582 so that the gains could offset other passive activity losses. Report all of the gains and losses on the forms and schedules you normally use and write to the left of the entry space, **"Entire disposition of passive activity."**

Publicly Traded Partnerships (PTPs)

A publicly traded partnership (PTP) is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent).

An established securities market includes any national securities exchange and any local exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions. It also includes any over-the-counter market.

A secondary market is generally indicated by the existence of a person standing ready to make a market in the interest. An interest is treated as readily tradable if the interest is regularly quoted by persons, such as brokers or dealers, who are making a market in the interest.

The substantial equivalent of a secondary market exists where there is no identifiable market maker, but the holder of an interest has a readily available, regular, and ongoing opportunity to sell or exchange his or her interest through a public means of obtaining or providing information of offers to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists where the prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a time frame and with the regularity and continuity that the existence of a market maker would provide.

Special Instructions for PTPs

Section 469(k) provides that section 469 must be applied separately to items from each PTP. Losses from passive activities held through a PTP generally can only be used to offset income or gain from passive activities of the same PTP.

Partners in PTPs must be able to identify which items of income and loss are from passive activities and whether these items of income or loss qualify for the passive loss phase-in provisions.

For tax years 1987 through 1990, losses from pre-enactment interests in passive activities are eligible for a gradual phase-in of the passive activity loss limitations.

For a definition of **pre-enactment interest,** see **Phase-In Rule** on page 6 and Temporary Regulations section 1.469-11T(c).

A partner's losses are from pre-enactment interests only if the activity is a pre-enactment interest of both the partnership and the partner.

Passive Activity Loss Rules for Partners in PTPs.—Do not include any income or loss from PTP passive activities on Form 8582. Instead, use the following rules to compute and report on the proper form or schedule your income, gains, and losses from the PTP passive activity or activities you held through each PTP you owned during the tax year:

1. Combine any current year income, gains and losses, and any prior year unallowed losses to see if you have an overall gain or loss. Include only the same types of income and losses you would include in figuring your net income or loss from a non-PTP passive activity (see **Passive Activity Income and Deductions** on page 5).

2. If you have an overall gain, the net gain portion (total gain minus total losses) is nonpassive income. When reporting the income and loss on the forms and schedules, identify the net gain portion as nonpassive income and the remaining income and the total losses as passive income and loss. Write to the left of the entry space, **"From PTP."** It is important to identify the nonpassive income because the nonpassive portion is included in modified adjusted gross income on line 6 of Form 8582. In addition, the nonpassive income is included in investment income for purposes of figuring your investment interest expense deduction on Form 4952.

Example: If you have Schedule E income of $10,000, Schedule E current year losses of $2,000, and Schedule E prior year unallowed losses of $3,500 from the PTP passive activities of a particular PTP, you have a $4,500 overall gain ($10,000 – $2,000 – $3,500). In Schedule E, Part II, report the $4,500 **"From PTP"** net gain as nonpassive income in column (k), the $5,500 of losses as a passive loss in column (g), and $5,500 of income as passive income in column (h).

3. If you have an overall loss (other than an entire disposition), the losses are allowed to the extent of the income, and the excess loss is carried forward to use in a future year when you have income to offset it. Report the portion of the loss equal to the income in column (g), and report the income in column (h).

Example: If you have a post-enactment activity with a Schedule E loss of $12,000 (current year losses plus prior year unallowed losses) and Schedule E income of $7,200, in Schedule E, Part II, report $7,200 of the losses in column (g) and the $7,200 of income in column (h). Carry forward the unallowed loss of $4,800 ($12,000 – $7,200).

If, however, the loss is from a pre-enactment interest, see **Pre-enactment Interest with Overall Loss** below to determine if any of the loss in excess of the income is allowed under the passive loss phase-in rule.

Pre-Enactment Interest with Overall Loss.—If you have a loss from a PTP passive activity, the partnership advised you that the partnership has a pre-enactment interest in the activity, and you have a pre-enactment interest in the activity, the loss may be allowed under the passive loss phase-in rule. Compute the allowed phase-in loss using the PTP worksheet below.

Computation of Phase-in Rule for Publicly Traded Partnerships (PTP)

If you owned an interest in more than one PTP during the tax year, this computation must be made separately for each PTP. Use lines 1a and 1b for net income and loss from activities in which the partnership and you have a pre-enactment interest. Use lines 2a and 2b for net income and loss from activities in which the partnership does not have a pre-enactment interest. Enter any prior year unallowed losses from both pre- and post-enactment activities on line 2c.

Complete lines 1a through 9 below only if you have an overall loss from passive activities held through a PTP.

1a	Pre-enactment activities with current year net income	1a		
b	Pre-enactment activities with current year net loss	1b		
c	Combine lines 1a and 1b		1c	
2a	Post-enactment activities with current year net income	2a		
b	Post-enactment activities with current year net loss	2b		
c	Prior year unallowed losses	2c		
d	Combine lines 2a, 2b, and 2c		2d	
3	Combine lines 1c and 2d. If the result is an overall gain, stop here and see the instructions above for how to report the income and losses from the activities on Schedule E		3	
4	Enter amount from line 1c. If this line is net income, skip to line 7; otherwise go to line 5		4	
5	Enter as a positive amount, the smaller of the loss on line 3 or line 4		5	
6	Multiply line 5 by 20% (.2) and enter the result		6	
7	Add income, if any, on lines 1a and 2a and enter the result		7	
8	**Total loss allowed from this PTP for 1989.** Add lines 6 and 7		8	
9	**Disallowed losses** from this PTP. Subtract line 6 from line 3		9	

Allocate the amount of disallowed losses on line 9 to your PTP passive activities with overall losses on a pro-rata basis. Then subtract the pro-rata amount from the total loss to get the allowed loss to report on the form or schedule you normally use. Keep a record of the disallowed amount on line 9 to be used in a future year.

You may use the worksheets on page 4 of Form 8582 to keep a record of allowed losses for each PTP. To do this, make extra copies of Worksheets 4 and 5. Use Worksheet 6 instead of Worksheet 5 if you have more than one loss to be reported on different forms and schedules for the same activity. List each activity of the PTP in Worksheet 4. Enter the overall loss from each activity in column (a). The overall loss for an activity is the loss you get after combining the net income and net loss from the activity (including any gain or loss on a disposition) and any prior year unallowed loss. Allocate the amount on line 9 above to each of the activities. Complete Worksheet 5 (Worksheet 6 if any of the activities have losses that are reported on more than one form or schedule). Enter the net loss plus any prior year unallowed losses in column (a) of Worksheet 5 (or Worksheet 6 if applicable). The losses in column (c) of Worksheet 5 (column (e) of Worksheet 6) are the allowed losses to report on the forms and schedules. Both these losses and any income on line 1a or 2a in the above worksheet should be reported on the forms and schedules you normally use. See the instructions on page 8 for how to report the income and losses on the form or schedule.

Nonpassive Income From PTPs.—If you have passive activities to report on Form 8582, the overall gain from a passive activity held through PTPs that is treated as nonpassive income is included when figuring modified adjusted gross income on line 6 of Form 8582. In addition, if you must complete **Form 4952,** Investment Interest Expense Deduction, any phase-in loss allowed (line 6 of the PTP worksheet) is included on line 3 of that form. If the PTP had net passive income (see Notice 88-75, 1988-2 C.B. 386), that amount is investment income for purposes of the investment income computation on Form 4952.